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# M E M O R A N D U M

**DATE:** September 11, 2001

**TO:** Metropolitan King County Councilmembers

**FROM:** Cheryle A. Broom, County Auditor

**SUBJECT:** Pacific Medical Center Interlocal Agreement

Attached for your review is the Pacific Medical Center Interlocal Agreement study report. The primary objective of the study was to evaluate PacMed's compliance to the provisions contained in the interlocal agreement with King County. The study focused on the following key provisions: 1) use of the bond proceeds in accordance with the project proposal; 2) restriction on the Beacon Hill facility for medical use only; 3) arrangement to provide charity care at not less than the 1988 level; and 4) on-going monitoring of the interlocal agreement by King County.

The general study conclusion is that oversight of PacMed's compliance to the interlocal agreement needs to be strengthened. The report makes recommendations to improve the county's oversight of the interlocal agreement with PacMed.

The Executive Response, included in Appendix 3, indicates that the executive generally concurs with our findings and recommendations. Responses to the individual findings and recommendations are incorporated into the audit text.

The Auditor's Office sincerely appreciates the cooperation received from the management and staff of the PacMed Clinics and the Department of Public Health.

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# SPECIAL STUDY

# PACIFIC MEDICAL CENTER INTERLOCAL AGREEMENT

Presented to
the Metropolitan King County Council
by the
County Auditor's Office

Cheryle A. Broom, CGFM, CIG, King County Auditor
Makoto (Mac) Fletcher, CPA, Principal Financial Auditor

Report No. 2001-03

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**Abbreviations**

| | |
|---|---|
| COPC | Community Oriented Primary Care |
| DHHS | U.S. Department of Health and Human Services |
| DPH | Seattle-King County Department of Public Health |
| DOD | U.S. Department of Defense |
| HMO | Health Maintenance Organization |
| PacMed | Pacific Medical Center |
| PAO | Prosecuting Attorney's Office |
| PDA | Preservation and Development Authority |
| SAO | State Auditor's Office |
| USTF | Uniformed Services Treatment Facility |
| WAC | Washington Administrative Code |
| WR&C | Wright Runstad & Company |

# REPORT SUMMARY

**Introduction**

The special study of the Pacific Medical Center (PacMed) Interlocal Agreement was initiated at the request of the Metropolitan King County Council and included in the council-adopted 1999 Auditor's Office work program. PacMed is a preservation and development authority (PDA) chartered by the city of Seattle. Under the bond issue approved by King County voters in November 1987, PacMed received approximately $9.3 million to accomplish structural improvement to its primary facility located on Beacon Hill within the city of Seattle. King County and PacMed have an interlocal agreement that defines the rights and duties of the respective parties regarding the accomplishment of the project and the use of the bond proceeds.

**Study Objective**

The objective of the special study was to evaluate PacMed's compliance to the provisions contained in the interlocal agreement with King County. The study focused on use of the bond proceeds, medical-use-only restriction on a portion of the Beacon Hill facility, and the arrangement to provide "charity care" at not less than the level demonstrated in 1988. The study also reviewed the adequacy of King County's oversight and monitoring of the interlocal agreement provisions.

**General Conclusion**

The general study conclusion is that the executive and the Department of Public Health (DPH) need to strengthen the oversight of the interlocal agreement to provide assurance that PacMed has complied with all key provisions of the interlocal agreement since it was signed in early 1991.

## SUMMARY OF FINDINGS AND RECOMMENDATIONS

**Finding 3-1 (Page 13)** **The PacMed Beacon Hill Facility Renovation Project was completed in accordance with the project proposal, and the bond proceeds were appropriately used for project purposes.**

PacMed transmitted the final project proposal to King County in March 1990. The final proposal was primarily to accomplish the seismic stabilization of the existing building through construction of the north tower addition as shell space only. The project was completed in August 1994 at a total cost of $12,391,938, of which $10,286,946 was the county share through the bond proceeds and interest thereon. Based on the audit staff review, the project appears to have been completed in accordance with the overall final project proposal, and the bond proceeds appear to have been used for appropriate project purposes.

**Finding 3-2 (Page 14)** **The size of the restricted space specified in the interlocal agreement was computed with outdated data. However, the error resulted in proportionately greater square footage being restricted for medical use.**

The interlocal agreement specified that PacMed set aside 66,000 square feet of the Beacon Hill facility as “restricted space” to be used only by nonprofit organization or state/local government(s) as part of the county regional public health care system. The square feet of the restricted space specified in the interlocal agreement was calculated using outdated data, but using a correct final plan and cost estimate would have resulted in only 54,000 square feet of restricted space. However, based on the legal review obtained by the audit staff, the restricted space specified in the interlocal agreement is binding on the parties

and, thus, approximately 12,000 additional square feet of restricted space was reserved for medical purposes.

**FINDING 4-1 (Page19)** **The executive and the Department of Public Health need to strengthen monitoring of PacMed's compliance to the charity care provisions specified in the agreement.**

In exchange for the bond proceeds, PacMed agreed to provide "charity care" to indigent and low-income patients at no less than 1988 level. A committee charged with the responsibilities for oversight of the charity care provision was envisioned in the interlocal agreement but never established. No charity care reports were received by the county for 1991 through 1994. In 1996, Executive Internal Audit issued a report pointing out the lack of oversight. Subsequently, Community Oriented Primary Care Division (COPC) of DPH was assigned the oversight responsibility. However, COPC did not request charity care reports until April 1998 and, upon receipt, accepted the reports although they did not contain all the required information.

**The study recommended** that the executive and the Department of Public Health review the interlocal agreement to ensure appropriate and timely reports are prepared and transmitted to a specific entity.

**FINDING 4-2 (Page 22)**

**In 1998, PacMed appeared to have provided community contribution at a level above the 1988 uncompensated care amounts in accordance with the interlocal agreement, but charity care reports received for other years since the bond issue have not been complete.**

PacMed prepared the required charity care report for 1998 (see page 23). The report indicates that PacMed provided charity care at the patients/visits level in an amount greater than the 1988 level, as required in the interlocal agreement. Audit staff tested the underlying details of the charity care data and found them to be fairly presented. However, King County did not receive the required charity care report for 1989 through 1994, and only partial data were provided for 1995 through 1997. Thus, the county does not have full assurance that charity care provisions were met for all the years since the interlocal agreement was approved in 1991.

**The study recommended** that the Department of Public Health consider requesting and reviewing historical charity care data, as required in the interlocal agreement, for all past years since bonds were issued in 1991.

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**Finding 5-1 (Page 27)**

**County oversight bodies named in the interlocal agreement were not established; thus, PacMed's compliance to all the provisions of the agreement was not adequately monitored.**

County oversight for the interlocal agreement with PacMed was to be provided through the Health Coordinating Committee. However, the committee was never established. While COPC was assigned to monitor the charity care provisions of the

interlocal agreement starting in 1996, its oversight has not been fully effective. Thus, charity care provisions and financial conditions of PacMed were not fully monitored, as required in the interlocal agreement.

**The study recommended** that the executive and the Department of Public Health ensure that all oversight mechanism(s) required under the interlocal agreement be appropriately established.

**The study further recommended** that the executive and the Department of Public Health apprise the council of the mechanisms established to oversee the interlocal agreement and transmit timely reports on any compliance issues.

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**Finding 5-2 (Page 30)** **PacMed has met the requirement to have an annual audit of its operations conducted; however, the audit reports were not submitted to any county agency.**

The interlocal agreement requires that PacMed have an annual audit of its operation. PacMed has had an independent certified public accounting firm conduct an examination of its financial statements, a review of internal controls, and determination of compliance to existing laws and regulations. However, due to lack of clarity regarding the appropriate oversight body, PacMed has not submitted the annual audit reports to the county except for 1998 and 1999.

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**Finding 6-1 (Page 33)** **The lease of the Beacon Hill facility appears to be within the existing legal and contractual requirements, including the interlocal agreement with King County.**

In 1998, PacMed leased substantially all of its Beacon Hill hospital building to a developer, who, subsequent to renovation work, sub-leased the building to a commercial internet retailer. Based on audit staff review, the lease appears to meet all the existing legal and contractual requirements. More specifically, since the interlocal agreement allows that the "Facility…may be mortgaged, or otherwise encumbered (including being made subject to an operating lease)…" and PacMed has retained the aforementioned "restricted space" for medical purposes (see Finding 3-2), it appears that PacMed is in compliance with the interlocal agreement.

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**Finding 6-2 (Page 35)** **The county was provided an opportunity to review the terms of the Beacon Hill facility lease to WR&C to ensure that the lease complied with a provision in the interlocal agreement.**

As early as June 1998, the county was afforded an opportunity to review the draft lease agreement between PacMed and the developer to ensure that the lease provisions were in compliance with the interlocal agreement.

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**Finding 7-1 (Page 37)** **Amendment 1 was not submitted for council review and approval as required in the interlocal agreement.**

Amendment 1 to the interlocal agreement, which revises the "charity care" requirements and the related definitions, was completed in September 2000. While the amendment was prepared by a working group consisting of representatives from

the Department of Public Health, the city of Seattle, PacMed, and the community clinics, the written instrument has not been presented to the King County Council, as required in the interlocal agreement. In addition, other procedures for an approval of such an instrument have not been followed.

**The study recommended** that the Department of Public Health and the executive prepare an appropriate motion to submit Amendment 1 to the interlocal agreement for Metropolitan King County Council's review and approval.

**The study further recommended** that the Department of Public Health ensure that the amendment follows appropriate review and approval procedures, such as signature authority, legal review, and proper references.

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**Finding 7-2 (Page 39)**

**The changes to the "charity care" definitions and reporting criteria made under Amendment 1 lack clarity and may limit the usefulness of compliance reports.**

The negotiation for the amendment began in mid-1996 but was not concluded until September 2000 due to some major disagreements among the participants. One effect of the extended negotiation was that no complete charity care report was prepared and, thus, monitoring of charity care provisions was not adequate. Moreover, the charity care provisions and reporting requirements, as revised, are not clearly or consistently defined throughout the amendment and its attachments. Thus, Amendment 1 limits the usefulness of the charity care compliance reports for the county's monitoring purposes.

**The study recommended** that the Department of Public Health ensure complete monitoring continues while a new amendment is being negotiated.

**The study further recommended** that the Department of Public Health work closely with PacMed to ensure that meaningful definitions, source data, and/or examples are included in any amendment to the interlocal agreement.

# AUDITOR'S MANDATE

The special study of Pacific Medical Center Interlocal Agreement was performed by the County Auditor's Office pursuant to Section 250 of the King County Home Rule Charter and Chapter 2.20 of the King County Code.

# 1 INTRODUCTION

**Background**

The special study of the Pacific Medical Center (PacMed) Interlocal Agreement[1] was initiated at the request of the Metropolitan King County Council, and included in the council-adopted 1999 Auditor's Office work program. PacMed, originally called Pacific Hospital, is a preservation and development authority (PDA) chartered by the city of Seattle. Under the bond issue approved by King County voters in November 1987, PacMed received approximately $9.3 million to accomplish structural improvements to its primary facility located on Beacon Hill within the city of Seattle. King County and PacMed has an interlocal agreement which defines the rights and duties of the respective parties regarding the accomplishment of the project and the use of the bond proceeds. In 1998, PacMed leased this facility to a private developer who sub-leased substantially all of the building to another commercial enterprise. The arrangement prompted the county council's request for the auditor to review the interlocal agreement. The request centered on an examination of the key provisions of the interlocal agreement and the impact, if any, of the lease on the interlocal agreement.

While a detailed background and history of PacMed and the interlocal agreement will be provided in Chapter 2, it should be noted here that Executive Internal Audit reviewed PacMed's compliance to the terms of the interlocal agreement in the mid-1990s. Their final report, issued in July 1996, raised a number of concerns regarding PacMed's compliance to the terms of the interlocal agreement and effectiveness of the county's

[1] Full title of the interlocal agreement is "Interlocal Cooperation Agreement Between Pacific Hospital Preservation and Development Authority and King County, Washington." See Appendix 1 for a copy of the interlocal agreement.

oversight. The Executive Internal Audit's findings and recommendations were reviewed by us and factored into this special study's work plan.

**Objective and Scope**

The objective of the special study was to evaluate PacMed's compliance to the provisions contained in the interlocal agreement with King County with the focus on the following key provisions:

1. Use of the bond proceeds in accordance with the project costs and description as proposed in the bond ordinance and/or the interlocal agreement;
2. Restriction on a portion of the Beacon Hill facility for medical services use only;
3. Arrangement to provide "charity care" at not less than the level demonstrated in 1988; and
4. On-going monitoring of the interlocal agreement by King County and reports to be provided to cognizant county agency(ies) by PacMed.

The county's authority to review PacMed is limited to its records and operations related to the provisions contained within the interlocal agreement. Accordingly, this special study was not intended to review the general operation or the financial condition of PacMed. Furthermore, while the lease agreement for the Beacon Hill facility was reviewed, the analysis was limited to the potential for any impact on PacMed's ability to continue to comply with the provisions of the interlocal agreement.

**Methodology**

The study was conducted through a review and analysis of the available documentation and procedures in existence at the time of the fieldwork (mid-1999 to mid-2000). Audit staff reviewed PacMed's project management documentation for the bond-funded structural improvements. For the charity care statistics, audit staff selected a sample of the latest complete annual (1998)

data available at the time of the fieldwork for verification. Additionally, audit staff performed other relevant procedures, including a walkthrough of the medical service portion of the Beacon Hill facility and interviews of key personnel representing PacMed and King County.

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# 2 BACKGROUND AND HISTORY

**Background and History**

Pacific Medical Center's primary facility is the hospital building[2] located on Beacon Hill within the city of Seattle. The building was constructed in 1932 as a U.S. Public Health Service Hospital and served in that capacity for 50 years. The Beacon Hill complex includes the hospital structure and a number of ancillary buildings, most of which are referred to as the "quarters" since they served as the living quarters for the hospital staff. These "quarters" buildings are now used as clinic and administrative facilities.

In 1981, the federal government announced the plan to close all U.S. Public Health Service Hospitals. In Seattle, a community campaign was organized to keep the hospital building as a part of the region's community health care system. Such efforts were successful and the hospital buildings were transferred to community control under a memorandum of agreement (November 1981) with the federal Department of Health and Human Services (DHHS). Under this agreement, the hospital was transferred to Public Health Hospital[3] Preservation and Development Authority (PDA), a city of Seattle chartered PDA. Also, with the concurrence of the U.S. Congress, PacMed was designated by the Department of Defense (DOD) as a uniformed services treatment facility (USTF) to provide health care to the retired and active military personnel and their dependents. Additionally, PacMed agreed to provide medical care to those individuals who were considered DHHS entitlement patients.

[2] The Beacon Hill hospital building has been listed on the National Register of Historic Places since 1979.
[3] While the agreement with DHHS refer to the PDA as "Public Health Hospital" PDA, substantially all other documents refer to the authority as "Pacific Hospital" PDA.

Under the memorandum of agreement, DHHS provided $26 million as "transition funds" to PacMed for the operating costs of the hospital.

**Seismic Stabilization of the Tower Building Proposed**

In 1987, the structural improvements to the PacMed's "Tower" building was identified by the Seattle-King County Health Coordinating Council as one of the region's top public health care capital project needs. The recommended structural improvements were to bring the building in compliance to the city of Seattle seismic code and redevelop the related heating and mechanical systems. Additional benefits of the proposal were stated as the preservation of a historic building, supporting a critical component of system of care for low-income and uninsured residents of King County, and creating some needed space for medical research activities.

**Voters Approved Regional Health Facilities Bond Issue**

The proposed capital fund for PacMed was included in the 1987 Regional Health Facilities Bond Measures. This bond proposal, submitted to the voters for approval through King County Ordinance No. 8196 (August 1987), requested a total of $99.8 million for three distinct needs: $75,465,000 for a modern trauma center, a replacement facility for the nursing units, and renovation of medical and surgical out-patient facilities for the Harborview Medical Center; $15,020,000, in the aggregate, for the Health Department clinics; and $9,315,000 for PacMed's structural improvements to meet seismic and other building codes. The voters approved this proposition in November 1987.

**$9.3 Million for PacMed**

**Interlocal Agreement Required**

A provision within Ordinance No. 8196 required that, before the PacMed portion of the bonds could be issued or sold, an appropriate interlocal cooperation agreement be executed and approved by the county council. The interlocal agreement between King County and PacMed, being separate governmental

entities, was intended to define the rights and duties of the respective parties regarding the accomplishment of the project and the use of the bond proceeds.

### Negotiation for the Interlocal Agreement Began in Late 1987

The negotiation process to write the interlocal agreement began soon after voter approval of the bond proposal. The working group was composed of county executive and council staff and representatives of PacMed; and was assisted by the county's bond counsel and financial advisor, Prosecuting Attorney's Office (PAO), city of Seattle staff, and the attorneys representing PacMed. The county and PacMed disagreed on virtually all key issues. Thus, negotiation for and drafting of the interlocal agreement was not completed until April of 1991, three and a half years later.

Based on the review of the documents made available to us, the key issues over the interlocal agreement involved the potential uses of the PacMed Beacon Hill facility and the scope of the construction project to be funded by the bond proceeds. There were several other specific issues, which also contributed to the delay. In addition, the county had overarching concerns. One concern was that the PacMed bond issue may not be tax exempt or may be a violation of the Washington State constitutional prohibition on "lending of credit," if the entire facility was not used for medical purposes. The other concern was the financial stability of PacMed and the affiliated medical services. Each of the specific issues are discussed in more detail below.

### PacMed Seeks Maximum Flexibility

#### Potential Use(s) of the Tower Building Discussed

Perhaps the most complex and contentious issue was the potential use(s) of the Beacon Hill facility. Initially, the county's position was that the entire hospital building should be used for

medical purposes only, whereas PacMed sought maximum flexibility in potential uses and occupants for the building. It seems fairly clear that it was the intent of PacMed management to lease the available spaces in the facility to any tenant deemed legally allowable including commercial entities. The county's position, that the building's users – lessee or otherwise – must be nonprofit and/or state/local government entities engaged in medical or health care purposes, was rooted in the Washington State constitutional prohibition on "lending of credit."[4] It was felt by the county that lease of any portion of the building, constructed and/or renovated by county bond proceeds, to a commercial entity would be considered constitutionally prohibited "lending of credit" and would jeopardize the federal tax exemption for the bond issue. The county's view was that, in order to meet the "except for the necessary support of the poor and infirm" provision of the constitution, all of the facility needed to be used for public health care delivery purposes. Since it was the county's view that the use of the facility must be clearly identified before issuing the bonds, the negotiation process for the interlocal agreement did not move forward expeditiously.

**King County Concerned Over Constitutional Prohibition**

### "Restricted Space" as Compromise on Building Use

In mid-1989 the concept of applying the medical use restriction on only the addition, i.e., the north tower, was formulated by the county's bond counsel. The restriction on facility use was further refined to represent the relative share of funds contributed by the county (the bond) versus the funds contributed by PacMed for the construction of the addition and/or the renovation of the added and/or existing floor spaces. In general, calculating the ratio of monetary contributions between PacMed and the county and applying the percent to the square footage of the floor

[4] Constitution of the state of Washington, Article VIII, Section 7, states, "No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation, except for the necessary support of the poor and infirm or become directly or indirectly the owner of any stock in or bonds of any association, company or corporation."

spaces added and/or renovated, to derive the "restricted space" for public or not-for-profit health care related services, were used in the final interlocal agreement.

### Scope of the Construction and Financial Contribution by PacMed

The second major issue was the scope of the construction project and, thus, the resulting financial contribution to the project by PacMed. As initially proposed, the PacMed project was described as structural improvements to the Beacon Hill facility to meet the Seattle seismic and other building codes and redevelop heating and mechanical systems. Furthermore, PacMed was considering one of two different methods[5] for the project. Since the project method and underlying financial estimate were required to be addressed in the interlocal cooperation agreement and, thereby, the bond issue, finalizing the project proposal became another barrier to a quick resolution to the PacMed interlocal negotiation process.

### PacMed to Fund Any Cost in Excess of Bond Amount

From the early phases of the negotiation, the county had substantial concerns with the financial stability of PacMed, which were directly impacting the construction project's scope. While the "north tower addition" was identified as the preferred stabilization method relatively early in the process, the specific project proposal and, therefore, financial contribution[6] by PacMed was not settled for some time. An April 1989 PacMed proposal described the project as the tower addition plus finishing six floors of the tower space and remodeling five existing floors. The estimated costs were approximately $15.3 million, with PacMed contributing $5.5 million. However, by early 1990 some of the

[5] In August 24, 1987 council staff report, the two methods were described as follows:

- Concrete core – construct a two-foot thick concrete wall around the central bay of the main tower and concrete foundation below the sub-basement level.
- North tower addition – construct an addition on the north side of the main tower to serve as a buttress.

[6] Since PacMed bond issue was set at $9.3 million by ordinance, any project costs in excess of the bond proceeds and related interest earnings was to be PacMed's responsibility.

concerns that the county had over the financial stability of PacMed were being realized. The Department of Defense, who provided 65% of PacMed's revenues through its USTF contract, was renegotiating the contract. At that time, it was estimated that the revised DOD contract would reduce the PacMed patient basis by over 6,000 and negatively impact its operating revenue by over $5 million. Another factor contributing to King County's concerns over PacMed's financial status was potential impacts of a federal policy change which would have considered certain billings to Medicare for USTF patients as double payments to PacMed. Furthermore, the Pacific Health Plans, a health maintenance organization (HMO) operated by PacMed, was incurring substantial operating losses.

**PacMed Reduces Construction Scope**

The county closely monitored these financial developments primarily through the analysis performed by the contracted financial advisor to the bond issue. By September of 1990, because of financial uncertainty, PacMed decided to reduce their equity contribution to the project to approximately $1.2 million (from $5.5 million proposed as late as January 1990). While PacMed's financial status remained uncertain, the financial adviser concluded that PacMed had adequate resources to carry on its operations within the near future and held adequate cash reserve to meet the obligations under the proposed construction project costs.

**"Community Contribution" by PacMed Addressed**

Other issues addressed by the interlocal negotiation team included the definition and the accurate reporting of the "community contribution" to be provided by PacMed. This contribution was considered a key element in PacMed's role in the regional health system and as a "return" for the bond proceeds provided for the Beacon Hill facility renovation project. Another concern was the potential of default by PacMed on the

interlocal agreement. This was later addressed by King County and city of Seattle entering into a separate interlocal agreement (April 1991) under which Seattle agreed to preserve the purpose[7] of the PDA, i.e., PacMed, and "guaranteed" to repay the county for any remaining obligations[8] under the bond issue if PacMed ceased to serve the purposes stated in the interlocal agreement.

### Negotiation Concluded in Early 1991

An agreement was reached in early 1991. It provided for the following key provisions (see Appendix 1 for the complete text of the interlocal agreement):

- The agreement is effective for 20 years following the bond issue;
- King County agrees to issue up to a maximum of $9,315,000 in general obligation bonds for the project;
- PacMed must submit a final project proposal for King County Council approval before the interlocal agreement is approved (this final proposal was to become an attachment to the agreement);
- As long as any bonds are outstanding, the facility will be owned by PacMed;
- 66,000 square feet of the facility is to be deemed "Restricted Space" to be used only for regional public health care purpose; and
- PacMed will maintain no less than the same level of charity care as demonstrated in 1988.

[7] Such purpose is described as "... provid(ing) necessary support for the regional health clinic system which provides health care to ... low income residents." The city agreed not to amend the PDA's charter or "... authorize any merger, intervention or trusteeship which would allow the Facility to be used for other than those uses authorized in the Interlocal Agreement ..."

[8] Also, in November of 1990, DHHS agreed to subordinate its interest in the Beacon Hill facility to any outstanding obligation. DHHS agreed that, in the event of any disaster, any proceeds from the property insurance be used first to pay off any outstanding county bonds.

### Council Approval and Bond Issued in April 1991

The "Interlocal Cooperation Agreement" was approved by the King County Council through Motion No. 8223 in March 1991 and was signed by the County Executive in April of 1991. Subsequently, the PacMed bonds, in the amount of $9,315,000, were issued in April 1991 under an authority granted in Ordinance No. 9920.

# 3 USE OF THE BOND PROCEEDS

This chapter discusses the findings and recommendations related to use of the county-provided bond proceeds of $9,315,000 including ownership and use requirements imposed on PacMed through the interlocal agreement.

**FINDING 3-1**

**THE PACMED BEACON HILL FACILITY RENOVATION PROJECT WAS COMPLETED IN ACCORDANCE WITH THE PROJECT PROPOSAL, AND THE BOND PROCEEDS WERE APPROPRIATELY USED FOR PROJECT PURPOSES.**

As noted in the previous chapter, PacMed's final project proposal was transmitted to King County in March 1990. This was in accordance with Article IV, Section 4.2 of the interlocal agreement. At the time of this proposal, PacMed committed to only Phase 1 of the originally contemplated four-phase[9] project. Phase 1 primarily was the seismic stabilization of the existing building through construction of the north tower addition as shell space only. The first phase also included renovation of the south entrance and replacement of the central heating system equipment. Phase 1 cost was estimated at $11.2 million with PacMed committing $1.2 million of their reserve for the project. County share was set at approximately $10 million consisting of $9.3 million bond proceeds and estimated $700,000 in interest earnings on the bond fund.

[9] The three (3) subsequent phases of the project, at the cost of $10 million to PacMed, would have remodeled and finished the tower addition and existing spaces for occupancy. By September of 1990, PacMed had downsized the project to only constructing the shell of the north tower addition.

**Project Management File Reviewed**

Audit staff reviewed the north tower addition project management file made available by PacMed procurement services. We reviewed such documents as project descriptions and drawings, billing statements to King County, the contract with the project's contractors and their invoices, and the permits issued by the city of Seattle. We also verified certain details, such as PacMed billings, against county records.

**Construction Project Completed in August 1994**

The construction project was completed in August 1994 at a total cost of $12,391,938, of which $10,286,946 was the county share. As indicated earlier, only the shell of the north tower addition, which provided net square footage increase of 61,126, was included in the final proposal and completed. Based on the review of the interlocal agreements and the available PacMed and county documents, the construction project appears to have been completed in accordance with the overall project final proposal, and the bond proceeds appear to have been used for appropriate project purposes.

**RECOMMENDATION**

None.

**FINDING 3-2**

**THE SIZE OF THE RESTRICTED SPACE SPECIFIED IN THE INTERLOCAL AGREEMENT WAS COMPUTED WITH OUTDATED DATA. HOWEVER, THE ERROR RESULTED IN PROPORTIONATELY GREATER SQUARE FOOTAGE BEING RESTRICTED FOR MEDICAL USE.**

In Article VI, Section 6.2, "Use of Facilities for Medical Service," PacMed and King County agreed to set aside 66,000 square feet of the Beacon Hill facility as "restricted space." The restricted space was to be used "…only by nonprofit organizations or state

or local governmental entities as part of the County regional public health care system…"

As noted earlier in the background and history section of this report, the potential use(s) of the facility was a contentious issue for the interlocal negotiating team. Initially, the county sought the use of the entire renovated facility for medical purposes only. On the other hand, PacMed staff's position was that they needed maximum flexibility to lease the building to any nonprofit and/or commercial enterprises.

**Restricted Space Based on a Ratio of Monetary Contributions**

At the suggestion of the bond counsel for the health care facilities bond issue, a compromise was reached around November of 1989. The compromise was to establish the relative contribution of the two entities to the renovation project and apply the resulting ratio to the square footage of the building added and/or improved. This formula was applied as illustrated in Exhibit A below.

**EXHIBIT A**

**Restricted Space Calculation [1]**

| | Per Interlocal Agreement [2] | Per Final Estimate [3] |
|---|---|---|
| Square Feet Added/Improved | 110,000 | 61,126 |
| Total Cost | $16.8M | $11.29M |
| County Contribution | $10.0M | $9.95M |
| Ratio, County Contribution to Total | 60% | 88.2% |
| Calculated Restricted Space (Approx.) in square feet | 66,000 | 54,000 |

[1] If calculated based on actual final costs, the "restricted space" computes to 50,747 square feet.

[2] Calculation based on dollar contributions and additional and improved floor spaces cited in the agreement.

[3] Calculation based on dollar contributions, and additional floor space cited in March 20, 1990 final estimate.

**SOURCE:** The interlocal agreement and audit staff analysis.

**Plan Data in Interlocal Agreement Outdated**

As shown in Exhibit A, the project plan data used to calculate the "restricted space" in the interlocal agreement was substantially outdated prior to approval of the final agreement. The interlocal agreement assumed addition and/or improvement of 110,000 square feet of the facility and that PacMed would contribute approximately $7 million of its funds toward the project. However, as early as March of 1990 – over a year before the agreement was signed and approved – PacMed had proposed a revised estimate. Due to the financial difficulties previously noted, PacMed's final project proposal reduced their contribution to approximately $1.2 million. Furthermore, the project scope was reduced to construct only the shell, i.e., no interior improvements, of the 61,000 square foot tower addition to provide seismic stabilization, and no funds were provided for interior improvement of the additional or the existing structure. It appears that the final cost estimate for the project was not incorporated into the interlocal agreement by the negotiating team before it was finalized and presented for council review and approval in early 1991.

**Inaccurate Data Resulted in Additional Restricted Space**

While the most current data available should have been used in the interlocal agreement, it appears that the use of the outdated data does not invalidate the "restricted space" provision of the agreement. Based on audit staff discussion with the council's legal counsel, the 66,000 square feet specifically described in the agreement can be interpreted as the parties' minimum requirement and, thus, legally binding. As shown in Exhibit A, the result of the agreed upon calculation was to reserve 12,000 additional square feet (per the interlocal agreement, 66,000 square feet less the 54,000 square feet based on the final cost estimate) as medical purposes "restricted space." It should be further noted that audit staff obtained the blue print for the ground and first floors of the tower building, which totals approximately 70,000 square feet, and toured the floors with a PacMed

employee to verify that they were used primarily[10] for the PacMed clinic and, thus, medical purposes.

| | |
|---|---|
| **RECOMMENDATION 3-2** | Executive staff should ensure that interlocal agreements, and all other similar or related contractual documents, properly reflect latest available data prior to their submission for council approval. |

[10] Portions of the ground floor are used by the other tenants of the building as property/project management office and freight receiving area.

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# 4 CHARITY CARE PROVISIONS

This chapter focuses on the findings and recommendations related to the "charity care" provisions of the interlocal agreement.

In Article VIII, Section 8.2, "Charity Care," it is stated that PacMed "…shall provide or otherwise arrange for charity care in exchange for a commitment for public funding of the project." The agreement also requires that PacMed "…will maintain not less than the same level of charity care as demonstrated in 1988 which will be measured by utilization statistics on Medicare/Medicaid, Discount Program, and Community Clinic Referrals and contractual allowances incurred for services to indigent and low-income patients…" Also, PacMed is to prepare an annual report in a specific format (see Attachment A of the interlocal agreement included as Appendix 1) for transmittal to the county. If charity care fell below the 1988 level, PacMed is to present a plan and timeline for corrective action. Per the agreement, the requirement was to be imposed for as long as any PacMed bonds are outstanding.

**FINDING 4-1** **THE EXECUTIVE AND THE DEPARTMENT OF PUBLIC HEALTH NEED TO STRENGTHEN MONITORING OF PACMED'S COMPLIANCE TO THE CHARITY CARE PROVISIONS SPECIFIED IN THE AGREEMENT.**

**Oversight Committee Was Not Established**

Based on the audit staff's review, it appears that adequate oversight of PacMed's compliance to the charity care provisions has not been in place since the approval of the interlocal agreement in early 1991. The interlocal agreement, in

Section 8.4, assigns the oversight responsibilities to the "Health Coordinating Committee,"[11] which was never established. It appears that no executive agency formally assumed all the responsibility to administer the terms of the interlocal agreement with PacMed until mid-1996 subsequent to Executive Internal Audit report (see below). The earliest PacMed report audit staff obtained was under a letter dated April 29, 1998 addressed to the deputy director of DPH. The report included only partial "community contribution" dollars for 1995, 1996, and 1997, and no comparison to the 1988 dollars was included as required in the interlocal agreement. Also, PacMed provided only a portion of the utilization statistics required in the interlocal agreement: no data on the number of charity patients were included and the total numbers (all payors plus charity patients) of all patients and visits were not included. Furthermore, according to the 1996 Executive Internal Audit report, the utilization statistics included some estimates and excluded other required data and, in general, were based on an inadequate tracking system. However, the charity care report was accepted by DPH's Community Oriented Primary Care Division (COPC) which was charged with monitoring the interlocal agreement starting in 1996.

### Executive Internal Audit Review of PacMed

**Inadequate Oversight Process Found in 1996**

Also, as indicated above, this is not the first time that the lack of oversight for the PacMed interlocal agreement was noted. The Executive Internal Audit Services, under a memo addressed to the Director of Public Health (dated July 17, 1996), issued a report on a "Review of Pacific Medical Center's Compliance With Its Interlocal Agreement With King County." The key finding of the report was that the county health official did not establish an

[11] The creation of a Health Coordinating Committee was mandated in the "1984 Agreement Regarding the Seattle-King County Department of Public Health." The committee was to be chaired by the director of the Department of Public Health and was to include representatives of the Mayor and County Executive, Harborview Medical Center, Pacific Medical Center, organized labor and community clinics.

appropriate oversight process as required and, thus, no determination whether the charity care services were provided at the agreed-to 1988 level could be made. While the Department of Public Health, in their response to the Executive Internal Audit report, assigned the oversight responsibilities to COPC, as earlier noted, it is not certain whether this was clearly communicated to PacMed, since one of the subsequent charity care reports was sent to the county's Department of Finance. Moreover, it appears that neither the executive nor the Department of Public Health took timely corrective action on the Executive Internal Audit recommendation regarding receiving and evaluating annual charity care reports, since no report was requested from PacMed until April 1998.

**Inconsistencies in Charity Care Reports**

Audit staff did find that the required annual reports were prepared and transmitted to the county in the last two reporting years. However, the packets of required reports for 1998 (under a memo dated August 5, 1999) and 1999 (memo dated August 18, 2000) were inconsistently transmitted by PacMed: the '98 packet was sent to the Department of Finance and the '99 packet to the Department of Public Health. Furthermore, the format and content of the reports for these two years were different. That is, while the 1998 report presented the details of patient utilization and dollar contribution data, both compared to 1988 base year in accordance with the interlocal agreement, the 1999 report only presented the reporting year's "charity" visits and limited "charity care" contribution dollars. These inconsistencies, in our opinion, are further indications that executive staff are not coordinating with PacMed officials to ensure transmittal of information that is required in the interlocal agreement. (See additional discussions in subsequent findings on 1998 data in Finding 4-2 and amendment to the agreement in Chapter 7.)

**RECOMMENDATION 4-1** The executive and the Department of Public Health should review the interlocal agreement with PacMed to ensure appropriate reporting of charity care requirements; timely transmittal to a specific oversight body(ies) and/or person(s) to review the report; and consistent and clear format of the report.

***Executive Response*** *"The PacMed charity care report for 2000 has been received. As part of reviewing this latest report, we will review the Interlocal Agreement with PacMed to achieve the objectives of your recommendations."*

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**FINDING 4-2**

## IN 1998, PACMED APPEARED TO HAVE PROVIDED COMMUNITY CONTRIBUTION AT A LEVEL ABOVE THE 1988 UNCOMPENSATED CARE AMOUNTS IN ACCORDANCE WITH THE INTERLOCAL AGREEMENT, BUT CHARITY CARE REPORTS RECEIVED FOR OTHER YEARS SINCE THE BOND ISSUE HAVE NOT BEEN COMPLETE.

PacMed prepared the Community Contribution Report (i.e., charity care report),[12] in accordance with the interlocal agreement for 1998. The report, which compares 1988 and 1998 data, is shown in Exhibit B.

[12] Audit staff contacted Center for Health Statistics, Washington State Department of Health, to obtain comparable "charity care" statistics. The state collects and publishes a report on charity care provided by Washington hospitals. However, as previously noted, PacMed is a system of clinics and contracts out its inpatient services. The state does not collect charity care data for such clinics at this time. Additionally, it was found that "charity care," per the state's report, did not fairly compare with the "community contribution" as defined in the interlocal agreement between PacMed and King County, i.e., the state defines the "charity care," including the Medicare and Medicaid reimbursement, in a substantially different manner than the existing PacMed interlocal agreement.

## EXHIBIT B

(Replicated from unaudited PacMed Clinic's Community Contribution Report)

## PacMed King County Community Contribution Report

| | 1998 Unaudited | 1988 Actual |
|---|---|---|
| **Patients (Unduplicated):** | | |
| Medicare | 5,458 | 1,464 |
| Medicaid | 3,771 | 2,271 |
| Charity[1] | 1,318 | 1,100 |
| Self-Pay | 8,093 | 4,248 |
| Contracted and Other | 74,751 | 34,050 |
| Total Visits (all payors) | 93,391 | 43,133 |
| **Visits:** | | |
| Medicare | 23,321 | 6,739 |
| Medicaid | 12,254 | 7,901 |
| Charity[1] | 3,381 | 3,200 |
| Self-Pay | 12,843 | 9,089 |
| Contracted and Other | 303,022 | 163,940 |
| Total Visits (all payors) | 355,091 | 190,869 |
| **Community Contribution:** | | |
| Medicare Contractual Allowances | $1,398,271 | $546,984 |
| Medicaid Contractual Allowances | 1,390,959 | 554,806 |
| Charity[1] | 1,112,013 | 747,715 |
| Bad Debts[2] | 1,737,567 | 567,094 |
| Subtotal | $3,901,243 | 1,849,505 |
| Interpreter Services | $1,327,961 | $99,947 |
| Cross Cultural Services | 503,599 | - |
| Subtotal | $1,831,560 | $99,947 |
| Total Community Contribution | $5,732,803 | $1,949,452 |
| Less: | | |
| Charity Care Grants | $0 | $0 |
| Interpreter Services Revenues | ($446,430) | $0 |
| Cross Cultural Program Income | ($464,658) | $0 |
| Net Community Contribution | $4,821,715 | $1,949,452 |

[1] Discounted charges for patients with incomes below Federal private guidelines.
[2] PacMed was unable to obtain information on the patient's income, so these amounts were written-off as bad debts. It is probable that most of these write-offs were for patients who would have had incomes below the Federal private guidelines.

**SOURCE:** All information in Exhibit B, including the footnotes, is replicated from unaudited PacMed Clinics 1998 Community Contribution Report.

The report indicates that PacMed has provided community contribution at the patients/visits level in an amount greater than the 1988 level, which is the requirement of the agreement.

### Test of Patient Data Conducted

To ensure that the charity care data provided by PacMed fairly reflects actual charity care services provided, audit staff conducted tests of the underlying details. The detail was reviewed by selecting a sample of charity care patients served in 1998. For those patients, we reviewed their account activities, which primarily details their service history and billing information.

### Verification of Charity Care Income Was Improved in 1999

The audit procedure above found that PacMed was not adequately verifying the income levels of the charity care patients.[13] Upon further inquiry, PacMed indicated that substantially all of the clinic referrals were provided charity care without additional income verification. PacMed noted, however, that they had subsequently instituted a new verification process for all low-income/indigent persons in early 1999. Accordingly, audit staff tested the new policy and the underlying procedures through an examination of the patient applications and accompanying supporting documentation and the computerized records. Audit staff found that the new income verification policy was adequate to identify patients eligible for the PacMed charity care program.

As earlier noted, the county did not receive all the required charity care data for 1989 through 1994, and only partial data were provided for 1995 through 1997. Thus, for nearly half of the

[13] Charity care is defined in the interlocal agreement as "Any medical/dental care rendered to indigent and low income persons for which the (PacMed) (or other health care provider) is not fully reimbursed by patients or third party payors. Contractual allowances shall be one of the elements included in the charity care measurement." Also, following terms are defined:

- "Low Income – Those patients whose gross income is below two hundred percent (200%) of the federal poverty standards, adjusted for family size, and who are covered by federal or state entitlement program." and
- "Indigent Persons – Those patients who have exhausted any third party sources of payments, and whose gross income is below two hundred percent (200%) of the federal poverty standards adjusted for family size."

period during which this bond issue is expected to be outstanding, the county and its tax payers have not been provided with reasonable assurance that PacMed has fulfilled the key obligation under the interlocal agreement to provide the required level of charity care.

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**RECOMMENDATION 4-2**

Department of Public Health should consider requesting and reviewing historical charity care data in the format as required in Attachment A of the interlocal agreement to ensure that PacMed was in compliance with the charity care provision of the interlocal agreement for all past years since bonds were issued in 1991. (Additionally, see discussion of PacMed 1999 Community Contribution Report in Chapter 7.)

***Executive Response***

*"PHSKC will consider this recommendation as part of its review of the Interlocal Agreement with PacMed that will be occurring as we review the charity care report for 2000."*

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# 5 OTHER COMPLIANCE ISSUES

This chapter discusses compliance with other requirements in the interlocal agreement, including monitoring procedures outlined to protect the county's interest.

**FINDING 5-1**

**COUNTY OVERSIGHT BODIES NAMED IN THE INTERLOCAL AGREEMENT WERE NOT ESTABLISHED; THUS, PACMED'S COMPLIANCE TO ALL THE PROVISIONS OF THE AGREEMENT WAS NOT ADEQUATELY MONITORED.**

In Article VIII, "General Authority (PacMed) Responsibilities," Section 8.4 of the interlocal agreement specifically stated that PacMed "…will cooperate with and assist the Health Coordinating Committee or its successors as long as any bonds are outstanding… for the purposes of (1) discussion of roles, responsibilities and the allocation of resources among the various public health care agencies in King County; (2) resolution of policy conflicts among various public care agencies in King County; and (3) making an annual report on its Charity Care service levels…" This Health Coordinating Committee was required to be established under the "1984 Agreement Regarding the Seattle-King County Department of Public Health" to develop a long-range, area-wide health plan; to provide a forum for the discussion of roles, responsibilities, and the allocation of resources among the various public health agencies; and to provide a forum for the resolution of policy conflicts among the various public health agencies.

As discussed in Chapter 4, the Health Coordinating Committee was never established. Furthermore, while COPC was assigned the oversight responsibility over the charity care provisions in the interlocal agreement in 1996, COPC accepted the charity care reports for the 1995 through 1997 period although they were incomplete. Also, the Health Coordinating Committee was to review and approve PacMed's annual "certificate of compliance," which was intended as PacMed's attestation to the county that it is not in default of any of its obligations, covenants, or undertakings under the interlocal agreement. These certificates were intended to provide assurances to the county that PacMed operations are not in financial jeopardy, and it can continue to provide charity care to the under-served population in King County. COPC, or any other county entity, did not request this key documentation until 1999. Thus, the county has received the annual certification for only the past two reporting years: 1998 and 1999.

**Department of Finance Performed Oversight of the Renovation Project**

The interlocal agreement also indicated that the county may establish a "Health Bond Oversight Committee" to oversee the progress of the county-approved project proposals, budgets, and schedules. Unlike the Health Coordinating Committee, this body was not mandated to be established in the interlocal agreement. Based on the audit staff review of the use of the bond proceeds (see Chapter 3 of this report), the county's Treasury Division, within the Department of Finance, assumed this responsibility and managed the "north tower addition" capital project oversight adequately.

As mentioned in Finding 4-1, the 1996 Executive Internal Audit report also noted the lack of an oversight process and expressed substantial concerns. That internal audit was initiated in 1995 when it was learned that county oversight mechanisms were

never established and therefore, reports necessary to monitor compliance were not prepared and transmitted to the county.

Finally, while the PacMed interlocal agreement was reviewed and approved by the Metropolitan King County Council, the executive staff has not kept the council informed of subsequent monitoring matters. Compliance issues were not communicated to the council. Those issues included the failure to establish a designated committee, concerns expressed by Executive Internal Audit, assigning oversight role to COPC, and the Treasury Division's assumption of bond project oversight.

**RECOMMENDATIONS**

**5-1-1** The executive and the Department of Public Health should ensure that all oversight mechanism(s) required under the PacMed interlocal agreement be appropriately established to ensure effective monitoring of compliance, such as policy review and annual verification of charity care service levels, and annual review of PacMed financial condition.

***Executive Response*** *"Initial attempts to convene the Health Care Coordinating Committee were not successful and an alternative mechanism for oversight was developed subsequent to the 1996 audit. This new mechanism (Community Health Services Division) assigned oversight accountability and meets the requirement of the Interlocal as a successor in function to the committee."*

**5-1-2** The executive and the Department of Public Health should apprise the Metropolitan King County Council of the mechanisms established to oversee the PacMed interlocal agreement by the executive branch and transmit timely reports on any compliance issues.

***Executive Response*** *"PHSKC agrees with the recommendations."*

## FINDING 5-2 PACMED HAS MET THE REQUIREMENT TO HAVE AN ANNUAL AUDIT OF ITS OPERATIONS CONDUCTED; HOWEVER, THE AUDIT REPORTS WERE NOT SUBMITTED TO ANY COUNTY AGENCY.

Under Article IX, Section 9.2, PacMed is required to have an annual audit of its operation, conducted by the Washington State Auditor's Office or an independent certified public accountant. Such audit is to include an examination of its financial statements, a review of internal accounting and other controls, and compliance with existing laws and regulations. Moreover, the completed audit report is to be submitted to the county.

### Annual Financial Audit Reports Reviewed

Audit staff reviewed the PacMed annual audit reports prepared by a certified public accounting firm. The accounting firm is contracted by PacMed Governing Council and reports on the management of the entity, in a manner similar to commercial sector annual financial audits. All annual reports are also provided to the State Auditor's Office for review. The reports reviewed by us were for the years 1991 to 1999. The independent auditor's report indicated that PacMed's financial statements fairly presented its financial status. Additionally, Washington State Auditor's Office has conducted its own independent audits, including certain special reports, all of which indicate general compliance to the accounting standards and to relevant laws and regulations.

We found that the earliest audited financial statements submitted to the county were included in a package sent to the Department of Finance in August 1999 for the fiscal year ending 1998. Also, 1999 financial statements were included in the package sent to COPC in August 2000. Thus, no reports on financial conditions of PacMed were provided to the county until eight years after the

approval of the interlocal agreement. As earlier noted, the poor operating results of PacMed was a major concern of the county at the time of the bond issue, which led to the request for the independent financial audit and other annual reporting requirements. According to PacMed, no reports were submitted due to lack of clarity regarding the appropriate oversight body. The issue of providing inadequate guidance on county oversight expectations to PacMed is discussed in Finding 4-1.

**RECOMMENDATION** None (see Recommendation 5-1-1).

***Executive Response*** *"PHSKC has received PacMed audits beginning with year ending December 31, 1998. We will continue to receive and review audits from PacMed as part of our implementation of Recommendation 5-1-1, which includes annual review of PacMed's financial condition."*

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# 6 LEASE OF THE BEACON HILL FACILITY

In 1998, PacMed leased substantially all of its Beacon Hill hospital building, the "facility," to a developer, Wright Runstad & Company (WR&C). The intent of the lease was for WR&C to improve and renovate the facility, including the unfinished spaces in the "north tower addition," and seek other tenant(s) for the building. Later, substantially all of the facility was sub-leased to Amazon.com, an internet retailer, as its administrative and sales offices.

This chapter reviews the underlying nature of the lease. Our focus, in accordance with our audit authority, was limited to the rights and interests of the county, as specifically provided in the interlocal agreement, and any relevant legal mandates affecting such rights and interests.

## FINDING 6-1 THE LEASE OF THE BEACON HILL FACILITY APPEARS TO BE WITHIN THE EXISTING LEGAL AND CONTRACTUAL REQUIREMENTS, INCLUDING THE INTERLOCAL AGREEMENT WITH KING COUNTY.

### Original DHHS Conditions Were Removed

As noted in Chapter 2, the facility was transferred from the federal Department of Health and Human Services (DHHS) in 1981. In the Quitclaim Deed, which conveyed the property, there were certain "conditions subsequent" limiting the use of the facility. One condition required the facility to be used as "a general health care facility," and another key condition stated that "the Grantee (PacMed) will not resell, lease, mortgage, or encumber, or otherwise dispose of any part of the Property or interest therein…" However, these conditions were abrogated in

**DHHS Requires PacMed to Use Lease Revenue for Community Healthcare**

return for extending other remaining conditions[14] by ten (10) years (adding to 40 years), and a commitment to apply "…the net proceeds PacMed receives from any tenancy of the Released Property…exclusively to the costs incurred by PacMed in connection with the performance of PacMed's Community Healthcare Mission and used solely for the provision of PacMed's charity and/or under compensated medical, pharmacy, and ancillary or related healthcare services, language interpretation for healthcare services, and healthcare training and outreach to underserved communities."[15] PacMed has agreed to the extension of other conditions, and DHHS and PacMed have signed the modification of the mortgage. Thus, the lease (and subsequent sublease) of the building to a commercial enterprise is within the federal mandate.

**Interlocal Agreement Allows for a Lease of the Facility**

The interlocal agreement between PacMed and King County specifically allows for a lease of the facility. In Article VI, Section 6.1, "Ownership," it's stated that "As long as any Bonds are outstanding, the Beacon Hill Facility will be owned…by the Authority (PacMed), …but may be mortgaged, or otherwise encumbered (including being made subject to an operating lease) to the extent permitted by law and this Agreement." As discussed in Chapter 3, the county specified the use restriction[16] on 66,000 square feet of the facility as "restricted space" to be used solely for health care purpose. Accordingly, PacMed has retained the basement and the ground floors of the facility, amounting to approximately 70,000 square feet, for its clinic and administrative purposes. Thus, PacMed is within the "lease" provision of the interlocal agreement.

[14] Other conditions included an access for audit and examination purposes and compliance to certain federal laws.
[15] Page 3, "Commitment," under the "Agreements" section of "Modification and Partial Abrogation of Conditions Subsequent and Partial Release of Mortgage." Dated August 26, 1998.
[16] The agreement section goes on to state that "Nothing in this section is intended to limit the Authority's ability to lease all or portions of the Beacon Hill Facility, subject to any applicable use restrictions set forth in this Agreement."

**SAO Reviewed the Lease in 1998**

Additionally, the lease issue was reviewed by the Washington State Auditor's Office (SAO). In a special report, "Pacific Hospital Preservation and Development Authority (Pacific Medical Center): Lease of Facilities to Wright Runstad & Co.," under a cover letter dated May 7, 1998, SAO concluded that PacMed complied with applicable laws and regulations and did not violate the terms of its charter or the deed from the federal DHHS.

**RECOMMENDATION**

None.

**FINDING 6-2**

**THE COUNTY WAS PROVIDED AN OPPORTUNITY TO REVIEW THE TERMS OF THE BEACON HILL FACILITY LEASE TO WR&C TO ENSURE THAT THE LEASE COMPLIED WITH A PROVISION IN THE INTERLOCAL AGREEMENT.**

**Lease Was Reviewed by the County in 1998**

As early as June 1998, the county was afforded an opportunity to review the draft lease agreement between PacMed and WR&C. The draft was provided to the Budget Director and a Senior Deputy Prosecuting Attorney at that time for review and comment. It appears that the lease provisions were found to be in compliance to the interlocal agreement

Also provided was the draft "Insurance Allocation Agreement" among PacMed, WR&C, the county, and the federal DHHS. This agreement was necessary to ensure an orderly distribution of insurance proceeds in the event of a catastrophic loss to the Beacon Hill facility. More specifically, the allocation agreement provides that "if insurance proceeds are not to be used to repair or reconstruct such damage or destruction …disbursed as follows, and in the following order of priority: (a) County Bonds.

Insurance proceeds which are attributable to the Bond Proceeds…shall be paid to the county as provided by and in satisfaction of the obligations of PacMed under Interlocal Agreement, up to the amount sufficient to redeem any outstanding Bonds;…" The provision appears consistent with the interlocal agreement's Article VI, Section 6.3, "Destruction of the Beacon Hill Facility," which establishes the order of priority in applying any insurance proceeds available in the event of the destruction of the facility, and Article X, Section 10.2, "Insurance," which requires PacMed to insure the facility against loss and/or damage.

**RECOMMENDATION** None.

# 7 AMENDMENT TO THE INTERLOCAL AGREEMENT

Department of Public Health, in cooperation with the city of Seattle, PacMed, and representatives from the community clinics, completed Amendment 1[17] to the interlocal agreement in September of 2000. The amendment was intended to redefine the charity care provision to better reflect such service in the current health care system. This chapter discusses the audit staff's analysis of Amendment 1 and the procedure used by DPH to amend the interlocal agreement. A copy of Amendment 1 is included as Appendix 2.

**FINDING 7-1** **AMENDMENT 1 WAS NOT SUBMITTED FOR COUNCIL REVIEW AND APPROVAL AS REQUIRED IN THE INTERLOCAL AGREEMENT.**

As noted earlier, the interlocal agreement with PacMed was approved by King County Council through Motion No. 8223 in March of 1991. The motion authorized the executive to enter into the agreement and ensure compliance to the terms of the agreement and other laws and regulations, including federal requirements for tax-exempt status for the PacMed bond issue.

**Amendment 1 Signed by DPH Without Council Review and Approval**

Article XII, "General Provision," Section 12.6, "Amendment," of the interlocal agreement states that "This agreement may not be amended or modified except by written instrument signed by the parties and approval by the King County Council." Amendment 1, signed by a representative of DPH on February 3, 2000 and "ratified" by the CEO of PacMed on September 2, 2000, has not been submitted to the Metropolitan

[17] To date there has been only one (1) amendment to the interlocal agreement.

King County Council for review and approval. Since the interlocal agreement specifically requires such approval and the original agreement was approved by the council through a motion (No. 8223), it is our understanding, through consultation with the council's legal counsel, that the amendment should have been formally presented to the council under a motion for review and approval.

**The Amendment Has Erroneous References and Was Not Reviewed by PAO**

Additionally, it appears that other procedures for an approval of such an instrument have not been followed. First, the amendment was signed by a representative of DPH, purportedly under authority granted by Motion No. 8222 (March 1991), and in a signature space for King County Executive. Motion No. 8222 approved the interlocal agreement between the city of Seattle and King County regarding the PacMed bond issue; thus, it is a reference to a wrong motion. Also, this motion makes no reference to delegation of authority. In fact, neither of the motions (Nos. 8222 or 8223) or the interlocal agreements (between the city and the county or PacMed and county) delegate authority to revise the interlocal agreement to DPH. Secondly, the amendment does not appear to have been reviewed by the PAO. While there is a signature space for the PAO approval (and the original interlocal agreement was so reviewed and approved as to form), it does not appear that the draft or the "final" amendment was routed to the PAO for review.

The interlocal agreement is a legal/contractual document between PacMed and the county. Failure to follow proper procedure to ensure that the amendment to such a document is appropriately prepared, approved, and signed increases the risk that compliance to the provision of that document may not be enforced or may become unenforceable. Following proper form and process helps protect the PacMed bondholders and the taxpayers of the county.

**RECOMMENDATIONS**

**7-1-1** The Department of Public Health and the executive should prepare an appropriate motion to submit Amendment 1 to the interlocal agreement for Metropolitan King County Council review and approval.

***Executive Response*** *See below.*

**7-1-2** The Department of Public Health should ensure that Amendment 1 to the PacMed interlocal agreement follows appropriate review and approval procedures including appropriate signature authority, legal review, and proper references.

***Executive Response*** *"PHSKC agrees with Recommendations 7-1-1 and 7-1-2. PHSKC had questions concerning the procedure for review and approval of the PacMed Interlocal Agreement, and, on advice of Executive staff, PHSKC contacted the Prosecuting Attorney's Office (PAO) for guidance. The PAO informed PHSKC that the agreement even though not approved by the Council was legally binding. Based on PAO advice, PHSKC concluded that the process was complete and did not need further review and approval. PHSKC now understands this process was incorrect and has amended their procedure."*

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**FINDING 7-2** **THE CHANGES TO THE "CHARITY CARE" DEFINITIONS AND REPORTING CRITERIA MADE UNDER AMENDMENT 1 LACK CLARITY AND MAY LIMIT THE USEFULNESS OF COMPLIANCE REPORTS.**

The impetus for Amendment 1 came from the July 1996 report by the Executive Internal Audit Services. The internal audit report found that "…current managed care practices do not fit the statistical reporting criteria established in this interlocal agreement, thereby making portions of that (i.e., charity care) reporting criteria meaningless." The underlying reasons for the finding were due to the general changes in the health care system including changes in Medicare and Medicaid programs

and in Washington State statutory definition of "charity care."

**Executive Internal Audit Planned an Audit After the 1996 Negotiations…**

Executive Internal Audit recommended that DPH negotiate acceptable criteria for measuring levels of charity care and that the interlocal agreement be amended to incorporate the results of the negotiations. After the negotiations were concluded, Executive Internal Audit planned to conduct a detailed audit of PacMed's compliance with charity care requirements. Executive Internal Audit's expectation was that this negotiation process would be concluded in 1996, and they would review PacMed's statistical information in 1997.

**… But Negotiations Not Concluded Until September 2000**

It is our understanding that the negotiation process did start in 1996. But the negotiations were not completed until September 2000, or four (4) years later. According to DPH, there were major disagreements among the participants as to the definition of "charity care" and application of lease revenues from the Beacon Hill facility for the charity care purposes. The differences were such that a mediator was retained to facilitate the discussions. One effect of the extended negotiation, as explained in Finding 4-1, was that no complete charity care report was prepared; thus, monitoring of the "charity care" requirements did not occur until late 1999, over eight (8) years after the bond issue.

Amendment 1, as completed (see Appendix 2), primarily revises the "charity care" requirements of Article VIII, Section 8.2, and related definitions in Article II of the interlocal agreement. "Charity care" has now been redefined as "any medical/dental care the Authority (PacMed) provides or otherwise arranges to be provided to indigent persons…" Moreover, "indigent persons" has been re-defined to reflect the definition in the Washington Administrative Code (WAC).[18] Also, PacMed is to "maintain not

[18] "Indigent persons" means those patients who have exhausted any third-party sources, including Medicare and Medicaid, and whose income is equal to or below 200% of the federal poverty standards, adjusted for family size or is otherwise not sufficient to

less than the same level of charity care as demonstrated in 1988 which will be measured by utilization statistics on that portion of the Authority's (PacMed) Discount Payment Program wherein services are provided to indigent patients and by providing not less than $1.5 million per year to indigent patients…" The revised Article VIII, Section 8.2, provides further definitions of "discount payment program" and references certain needs to refine "internal processes" for patient tracking.[19] Amendment 1 also provides some attachments as the formats for charity care reporting, though no specific numerical data is presented.

Exhibit C presents PacMed's "1999 Utilization Statistics and Uncompensated Charity Care Report."[20] The report appears to be prepared in a format specified in Amendment 1 and its attachments.

enable them to pay for the care or to pay deductibles or coinsurance amounts required by a third-party payor WAC 246-453-010 (4)." WAC Chapter 246-453 was last updated in June of 1994.

[19] This process appears to be intended so that "…as many patients as are reasonably possible who should be identified as charity care patients are so identified…" Until that process is completed, PacMed is authorized to include bad debt costs in excess of the industry standard towards meeting the $1.5 million per year. It appears that this process is to be completed by the close of the year 2000.

[20] PacMed also provides a narrative "Community Contribution Report."

**EXHIBIT C**
(Replicated from 1999 PacMed Charity Care Reports)
**PacMed 1999 Utilization Statistics and Uncompensated Charity Care Report**

| | Actual 1999 |
|---|---|
| **Visits:** | |
| Charity | 3,899 |
| **Charity Care:** | |
| PacMed Charity Discounts[1] | $868,405 |
| PacMed Excess Bad Debts[2] | 0 |
| Arranged Charity Discounts[3] | 526,899 |
| Interpreter Services[4] | 255,660 |
| Cross Cultural Services[4] | 280,874 |
| Total Charity Care | $1,931,838 |

[1] PacMed's discounted charges for medical and pharmacy services provided to patients with incomes below federal poverty guidelines.

[2] PacMed's bad debts in excess of 2.0% of annual gross fee-for-services charges are considered to be charity care discounts. This is to allow for patients who have no insurance coverage, and who would have qualified for charity discounts. But the patients failed to pay their accounts, and did not apply for charity discounts. In 1999, PacMed's bad debts expense was $477,761, which was less than 2% of annual gross fee-for-services charges.

[3] PacMed arranges through its provider network contracts for charity care to be provided to charity patients by other medical providers who receive charity care patient referrals from PacMed.

[4] Programs fully allocated costs, less program revenues.

**SOURCE:** All information in Exhibit C, including the footnotes are replicated from the 1999 PacMed charity care reports

**The Revised Charity Care Reporting Criteria Not Clear or Consistent**

As Exhibit C shows, the charity care report does not present the comparison of the statistics and the dollars of charity care provided between the reporting year (1999 in this case) and the base year, 1988. Also, while "discount payment program" has been described in the definition section as "the program maintained by the Authority to financially assist those patients who are indigent persons…," for charity care reporting purposes, Amendment 1 requires PacMed to provide not less than $1.5 million per year in "…costs for charity care visits, interpreter services…, cross cultural services…" PacMed is also authorized to include bad debt costs in excess of the industry standard as part of the $1.5 million per year charity care commitment. Thus, definition of the charity care dollars is not well defined or

consistent throughout the amendment. Finally, the basis of the $1.5 million charity care commitment is not clear, since no description of underlying source(s) or criteria of the dollar value, such as a combination of program costs in 1988 or certain "return" on the county's investment of $9.3 million bond moneys, is provided.

These different descriptions and definitions and the lack of clearly presented format and examples limit the value of current reporting. To provide meaningful monitoring, the required reports should clearly provide comparative and relevant information in a consistent format. Examples or explanatory notes of the basis for analyzing the current year's data would also be beneficial.

## RECOMMENDATIONS

**7-2-1** The Department of Public Health should ensure that monitoring of existing reporting requirements continues while a new amendment to the interlocal agreement is negotiated and approved.

***Executive Response*** *See below.*

**7-2-2** The Department of Public Health should work closely with PacMed to ensure that appropriate definitions, source data, and/or examples be included in any amendment to the interlocal agreement to ensure meaningful charity care reports are prepared and transmitted so adequate monitoring of charity care requirements can occur.

***Executive Response*** *"Amendment 1 will be submitted to the County Council for review and approval. It was the product of lengthy negotiations between PacMed and PHSKC. Representatives of the community health centers also participated in these negotiations because comprehensive specialty care services to patients of the regional community clinic system as well as PHSKC have been a priority component of the charity care requirement.*

*"It is our belief that the representatives of the three entities that negotiated the amendment are experts in the definition of charity care in the community health system environment. With their help, we will work to clarify the format of the charity report to assure that adequate monitoring of the charity care requirements occurs."*

# APPENDICES

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**See separate PDF files for Appendix 1, 2, and 3.**